

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-01(21)S
Sales Tax
July 31, 2001

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S990622C

On June 22, 1999, the Department of Taxation and Finance received a Petition for Advisory Opinion from Alan J. Goldstein/The Computer Studio, 2 Pennsylvania Avenue, Tuckahoe, NY 10707.

The issues raised by Petitioner, Alan J. Goldstein/The Computer Studio, are as follows:

1) Whether receipts from the sales of Petitioner's Web site development services are subject to sales and compensating use taxes.

2) Whether the purchase by Petitioner of computer software for use in its Web site development services, or the use by Petitioner of software it develops in-house, is subject to sales or compensating use tax.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

Petitioner is engaged in the business of advertising and Web site development for companies located both within and outside of New York State. The Web sites Petitioner develops may be used for purposes of advertising and promotion (the most common application), Internet commerce and other communications and support functions.

A Web site is a series of linked pages that may be accessed by anyone connected to the Internet using a computer with World Wide Web browser software. When operational, the Web site will usually reside on a remote server that is on the premises of, and is operated by, a third party Internet Service Provider (ISP). The ISP usually provides the following services:

- Operates and maintains the computers that the World Wide Web server software runs on, including system back-ups.
- Maintains other software, such as database software and programming languages, which may interact with the Web site. This other software may run on the same machine as the Web server, or on a different machine located at the ISP's facility.
- Operates networking facilities to allow the Web server and other supporting software, as well as Petitioner's clients' Web sites, to be accessed by anyone connected to the Internet.

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The ISP is a separate company from Petitioner and its clients, and may be located either within New York State or outside of it. Currently, Petitioner's clients contract directly with the ISPs for the above services. In the future, Petitioner may contract to resell the services of an outside ISP to its clients. Once a client's ISP account is activated and the client is given an Internet address by the ISP, Petitioner places the Web site on a server which stores the site for access by users of the World Wide Web. Once the Web site exists on the server, it can be accessed by the public from around the world.

Petitioner also anticipates developing private Web sites at some time in the future, which will make use of Web servers and browsers that work the same way they do on the World Wide Web. These sites will allow potential client companies to distribute private business information to authorized users only, such as employees (Intranet) and external customers and suppliers (Extranet). They will generally be segregated from a client's public Web site as described above.

The Web sites Petitioner develops may contain any combination of the following elements:

- Pages which contain text and artwork, and are formatted using HTML (a markup language understood by the browser that determines the way the items will appear on the page).
- Embedded programming (scripts) within the HTML pages that may be executed by the viewer's browser software, or by software operating on the server at the ISP's facility.
- Software programs and databases that reside with the ISP and interface with Web pages belonging to the Web site.
- Software programs that Web pages download to the viewer's machine, to be executed there.
- Software interfaces that interact with applications and/or databases that reside on computers located at the clients' facilities.

Petitioner's Web site development services may include any combination of the following services:

- Consulting on business strategy and Web site design.
- Writing of copy (text), page design and development of artwork for the Web site.

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- Creating pages for the Web site using HTML, optionally including scripts to be executed on the viewer's browser and/or on the server.
- Writing programs in any of a variety of computer languages and setting up databases.

Petitioner's Web sites are transferred to its clients in any of the following ways:

- Uploaded to the ISP's computer over the Internet (this is the most common method).
- Delivered to the client via magnetic or other media.
- Delivered to the ISP via magnetic or other media (rare).

Petitioner and/or its clients are provided a password by the ISP in order to maintain some control over the server, such as uploading or deleting files, creating file directories, changing permissions and the like. These tasks are all handled over the Internet. At no time does Petitioner or its clients actually operate the servers locally. There are many aspects of system operation that Petitioner and its clients are not able to perform as a result of restrictive permissions set by the ISP, and/or lack of remote support for those functions.

Most often, the servers and other equipment on the ISP's premises are owned by the ISP and are concurrently used by many of the ISP's customers. Petitioner's clients may opt to lease a dedicated server owned by the ISP if there is a lot of activity at their Web sites. One year agreements of this nature are common, although they can also be on a month to month or longer term basis. Petitioner's clients may also purchase their own server, to be operated by the ISP on the ISP's premises, using the ISP's networking facilities and other services.

Applicable Law and Regulations

Section 1101(b) of the Tax Law states, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to

tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. . . .

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

(6) Tangible personal property. Corporeal personal property of any nature. . . .Such term shall also include pre-written computer software, whether sold as part of a package, as a separate component, or otherwise, and regardless of the medium by means of which such software is conveyed to a purchaser. . . .

* * *

(14) Pre-written computer software. Computer software (including pre-written upgrades thereof) which is not software designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two or more pre-written computer software programs or pre-written portions thereof does not cause the combination to be other than pre-written computer software. Pre-written software also includes software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than such purchaser. Where a person modifies or enhances computer software of which such person is not the author or creator, such person shall be deemed to be the author or creator only of such person's modifications or enhancements. Pre-written software or a pre-written portion thereof that is modified or enhanced to any degree, where such modification or enhancement is designed and developed to the specifications of a specific purchaser, remains pre-written software; provided, however, that where there is a reasonable, separately stated charge or an invoice or other statement of the price given to the purchaser for such modification or enhancement, such modification or enhancement shall not constitute pre-written computer software.

Section 1105(a) of the Tax Law imposes sales tax on the “receipts from every retail sale of tangible personal property, except as otherwise provided in this article.”

Section 1105(c) of the Tax Law imposes sales tax upon receipts from the sales, except sales for resale, of certain enumerated services.

Section 1110 of the Tax Law provides, in part:

(a) Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state . . . except as otherwise exempted under this article . . . (F) of any computer software written or otherwise created by the user if the user offers software of a similar kind for sale as such or as a component part of other property in the regular course of business

* * *

(g) For purposes of clause (F) of subdivision (a) of this section, the tax shall be at the rate of four percent of the consideration given or contracted to be given for the tangible personal property which constitutes the blank medium, such as disks or tapes, used in conjunction with the software, or for the use of such property, and the mere storage, keeping, retention or withdrawal from storage of computer software described in such clause (F) by its author or other creator shall not be deemed a taxable use by such person.

Section 1115 of the Tax Law provides, in part:

(a) Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(35) Computer system hardware used or consumed directly and predominantly in designing and developing computer software for sale or in providing the service, for sale, of designing and developing internet websites.

* * *

(o) Services otherwise taxable under subdivision (c) of section eleven hundred five or under section eleven hundred ten shall be exempt from tax under this article where performed on computer software of any nature; provided, however, that where such services are provided to a customer in conjunction with the sale of tangible personal property any charge for such services shall be exempt only when such charge is reasonable and separately stated on an invoice or other statement of the price given to the purchaser.

Section 526.6(c)(7) of the Sales and Use Tax Regulations provides:

Tangible personal property purchased for use in performing a service not subject to tax is not purchased for resale.

Technical Services Bureau Memorandum, TSB-M-93(3)S, March 1, 1993, pertaining to the taxability of computer software and certain related services provides, in part:

Effective September 1, 1991, State and local sales and compensating use taxes are imposed on the sale or use of prewritten computer software and certain related services.

The effect of this change in the Tax Law is to broaden the types of computer software that are subject to sales and use taxes. . . . certain software previously considered "custom" may now be considered *prewritten computer software* and subject to such taxes. . . . The only software that is exempt from sales and use taxes under the new law is software designed and developed to the specifications of a specific purchaser.

Prewritten computer software is any computer software that is not designed and developed by the author or other creator to the specifications of a specific purchaser.

* * *

Software that was originally designed and developed to the specifications of a specific purchaser (i.e., "custom" software) loses its identity as such and becomes prewritten software, subject to tax, if and when it is sold to someone other than the person for whom it was specifically designed and developed. . . .

Prewritten software is subject to tax whether sold as part of a package or separately. Software created by combining two or more prewritten programs or

portions of prewritten programs is still prewritten software subject to tax. The medium by which the software is transferred to the purchaser has no effect on the software's taxability. Thus, prewritten software is taxable whether sold, for example, on a disk, tape or by electronic transmission over telephone lines.

Prewritten software, even though modified or enhanced to the specifications of a specific purchaser, remains prewritten software subject to tax. However, if a charge for the custom modification or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the custom modification or enhancement is not subject to tax.

The incidental use of a development language (e.g., COBOL, BASIC, C, etc.) or of libraries of "prewritten" functions or routines in designing and developing a "custom" software program to the specifications of a specific purchaser will not, in and of itself, make the sale of an otherwise custom program taxable. The "custom" program must be examined as a whole to determine whether it is exempt from tax. If the prewritten components of a custom program are sold separately, their sale is subject to tax.

* * *

Use tax generally applies to taxable uses of prewritten computer software in the same manner that the use tax applies to uses of other tangible personal property, except that: (1) no use tax is imposed on software used by its author if the author does not offer similar software for sale in the regular course of business, and (2) where software is used by its author and the author does sell the same or similar software in the regular course of business, use tax applies and is computed on the cost of the medium (floppy disk, magnetic tape, etc.) that contains or is used in conjunction with the program.

Opinion

Petitioner designs and creates Web sites which, at the end of this process, exist as computer text, graphics and underlying programming code. Petitioner's Web sites are designed to interact with the Internet by means of coded instructions that are understood and interpreted by a viewer's browser. The Web sites are used by Petitioner's client companies for purposes of advertising and promotion, Internet commerce and other communications and support functions.

The services which Petitioner provides its clients include any combination of consulting, page design/creation, and development of artwork for the Web site. After the site is designed, it is

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uploaded by Petitioner to an Internet Service Provider's (ISP) server or to Petitioner's client's server, located on the premises of and operated by an ISP. The Web site can then be accessed by anyone connected to the Internet using browser software. The Web site may also be delivered via magnetic or other media either directly to Petitioner's clients or, rarely, to an ISP. Currently, Petitioner does not maintain servers or host Web sites for fees, but in the future it may contract to resell these services purchased from outside ISPs to its clients. Also in the future, Petitioner may develop private Web sites which will allow its clients to distribute private business information to authorized users only.

The Web site development service that Petitioner provides to its clients, which involves consulting, designing and the creation of a Web site by Petitioner, and in many cases the transfer of Web sites to remote servers, somewhere on the Internet and accessible by the public, is not included among the enumerated services that are subject to New York State and local sales and compensating use taxes. This is so, regardless of whether the Web sites are created for purposes of advertising or promotion, Internet commerce or other communications and support functions (see David H. Posmantier, Adv Op Comm T&F, June 7, 1999, TSB-A-99(31)S; K2 Design Incorporated, Adv Op Comm T&F, July 23, 1997, TSB-A-97(43)S; Pat Rolland, Adv Op Comm T&F, July 23, 1997, TSB-A-97(41)S; Ski Soft, Inc., d/b/a Ski Areas of New York Internet Publishing Services, Adv Op Comm T&F, June 25, 1997, TSB-A-97(35)S). Accordingly, Petitioner's charges to its clients for such services are not subject to sales or compensating use tax. Any future charges for hosting fees charged by an ISP that Petitioner pays and passes through to its clients are not subject to sales or compensating use tax (see CAV CORP d/b/a Stone Soup Multimedia, Adv Op Comm T&F, December 29, 1997, TSB-A-97(87)S; Ski Soft, Inc., supra). The hosting fees are not charges for services that are included among the enumerated services that are subject to tax. Additionally, such fees are not fees for the rental of tangible personal property.

Petitioner's purchase of prewritten software for use in performing its Web site development service is subject to tax under Section 1105(a) of the Tax Law as a purchase at retail of tangible personal property. See Section 1101(b)(6) of the Tax Law. The purchase by Petitioner of custom software designed and developed to Petitioner's specifications is not taxable. Prewritten software, even though modified or enhanced to the specifications of a specific purchaser, remains prewritten software subject to tax. However, if a charge for the custom modification or enhancement is reasonable and separately stated on the invoice or billing statement, then the separately stated charge for the custom modification or enhancement is not subject to tax. See TSB-M-93(3)S.

Petitioner's use in its Web site development service of software that it develops in-house is not subject to compensating use tax if similar software is not offered for sale by Petitioner in the regular course of business. If similar software is offered for sale in the regular course of business,

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then Petitioner's use of the software would be subject to tax based on the cost of the medium that contains or is used in conjunction with the program. See TSB-M-93(3)S.

DATED: July 31, 2001

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.